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IN THE

# SUPREME COURT

OF THE

# UNITED STATES.

October Term, 1935.

Number 348.

CITY OF LINCOLN, NEBRASKA, AND STANDARD ACCIDENT INSURANCE COMPANY, PETITIONERS,

V.

L. A. RICKETTS, AS TRUSTEE IN BANKRUPTCY OF LINCOLN TRUST COMPANY, BANKRUPT, RESPONDENT.

## REPLY TO RESPONDENT'S BRIEF.

KARL W. KINDLEBERGER,
DON W. STEWART,
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WERESSER-BRINKMAN CO., Law Briefs, Lincoln, Neb.

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*Counsel for Petitioners.*

## STATEMENT.

Respondent's brief presents several questions which we did not deem proper to discuss in our original brief be-

cause of the limited scope of the appeal. The order granting certiorari stated that it was "limited to the application of Section 64b of the Bankruptcy Act" (R. 129). We interpreted this order to restrict the appeal to the question as to whether Section 64b applied to a municipal corporation. If that question is decided by this court in the affirmative, then we have assumed that priority would be given to the City's claim. Under such conditions we limited our original brief to the application of Section 64b to a municipal corporation and a short statement of the statute and authorities entitling a Nebraska municipal corporation, under Section 64b, to the right of priority accorded a sovereign at common law. Because of the limited nature of the appeal we question whether respondent may assert other grounds than those given by the Circuit Court of Appeals for the purpose of supporting its judgment. For the reasons given, we do not believe the new questions presented in respondent's brief are properly before the court, but in the event they are given consideration by the court we submit this reply brief.

## I.

### Right of Priority Has Not Been Waived.

It is asserted by respondent on pages 18 to 22 of his brief that the City has waived its right to the priority accorded a sovereign because it failed to assert such right prior to the time the Trust Company was adjudicated a bankrupt.

The record does not show that the respondent raised any such question either before the Referee or before the District Court. The question was first raised in respondent's brief filed in the Circuit Court of Appeals. Objection was then made by petitioners in a reply brief filed in the Circuit Court of Appeals that the question was not properly before the court.

The record shows that the right of the City to priority as a sovereign was asserted, considered and passed upon by the Referee (order disallowing priority R. 25, 26, certificate of Referee on review R. 36). It was also considered by the District Court (request for findings of fact and conclusions of law R. 38, original order allowing priority as a sovereign R. 39, later order denying right of a sovereign to priority R. 43, and finding of fact that City, ever since the amendment of its claim, has asserted the sovereign right of priority R. 58). It was likewise considered by the Circuit Court of Appeals (R. 122 and 123). In view of the fact that the Referee and the District Court passed upon the right to priority as a sovereign without any question being raised by respondent of a waiver of such right and that the Circuit Court of Appeals did not consider the claim that such right had been waived, we do not believe the question is properly before this court because of the well recognized rule that appellate courts will not pass upon questions which are presented there for the first time. See *In re Schulte*, 59 Fed. (2d) 553, 559 (C. C. A. 8), and *Bachman* v. *McCluer*, 63 Fed. (2d) 580, 583 (C. C. A. 8).

Furthermore, we do not believe the question is properly before this court in view of the provision of the order granting certiorari that it is "limited to the question of the application of Sec. 64b of the Bankruptcy Act" (R. 129). However, if this court should deem it proper to consider this particular contention, we believe it will be found to be without merit. None of the authorities cited by respondent support his statement that the right of a sovereign to priority under Section 64b of the Bankruptcy Act is lost if not asserted before bankruptcy.

The cases cited by respondent that a trustee's lien is superior to other liens are not in point because the right of a sovereign to priority under Section 64b is not based

on a lien but is a rule to be followed in the distribution made to creditors. To require the assertion before bankruptcy of such right of priority would be unjust and impractical and would frequently deprive a creditor of a priority to which he was otherwise entitled. See *Lott* v. *Salsbury*, 237 Fed. 191 (C. C. A. 4).

As a matter of fact the right to such priority need not be asserted until the trustee is ready to pay dividends to creditors. See *In re Worcester County*, 102 Fed. 808, 813 (C. C. A. 1) and *In re Jones*, 151 Fed. 108, 110 (D. C. Mich.).

Respondent concedes that *State of Oregon* v. *Ingram*, 63 Fed. (2d) 417, 420 (C. C. A. 9), certiorari denied 290 U. S. 630, and *In re Alamac Operating Corporation*, 42 Fed. (2d) 120 (C. C. A. 2) hold that the right of a sovereign to priority may be asserted after the commencement of bankruptcy proceedings. Respondent states that these two cases stand alone. The reasoning in these cases is logical and the rule announced therein justifies its adoption by this court.

In the more recent case of *In re Martin*, 75 Fed. (2d) 618, 621 (C. C. A. 7), the court rejects respondent's contention, stating that if it were correct, Section 64b "would wholly fail of its manifest purpose to preserve in bankruptcy whatever right of priority the creditor had under the laws of the state before the bankruptcy intervened."

Summarized, it is petitioner's contention that the question of a waiver by the City of its right to priority as a sovereign because it failed to assert such right prior to bankruptcy is not properly before this court but if it is considered there is no merit to the claim of a waiver

Under the authorities cited the right to priority can be asserted any time before payment of dividends. The right having been considered by the Referee and the District Court without any claim of waiver being made and the right of the City to the priority of a sovereign having also been considered by the Circuit Court of Appeals, it should now be determined by this court upon its merits.

## II.

### Decisions Cited By Respondent Do Not Support His Contention That the Common Law Right of a Sovereign to Priority Is Not Recognized in Nebraska.

Respondent, on page 23 of his brief, states that the Nebraska statute adopting the common law has been before the Supreme Court of Nebraska "on several occasions and in nearly every instance the court has found it ineffective for one reason or another." Respondent then cites a number of Nebraska cases construing this statute. However, **every one** of these cases recognizes the common law as a part of the Nebraska law in the absence of a constitutional provision or legislative act on the subject. The only reason why the common law rule is not followed in the cases cited by respondent is because in each instance a Nebraska statute had been enacted which in some way changed the common law rule.

### 1. Recent Nebraska Decisions Recognize Common Law As Adopted By Statutory Provision.

As a matter of fact the statutory provision adopting the common law has been repeatedly recognized in Nebraska. Within the past year the Supreme Court of Nebraska has, in at least three different cases, applied the common law because of its adoption by this statute.

The latest expression of the Supreme Court of Nebraska on this statute adopting the common law is found in *Roberts* v. *Rogers*, 261 N. W. 354, not yet contained in the Nebraska reports. In that case the court says:

> "In other words, in this jurisdiction, by legislative action (Comp. St. 1929, sec. 49-101), we have adopted the common law of England as governing the relation of landlord and tenant."

In the recent case of *Carlsen* v. *State*, 261 N. W. 339, not yet contained in the Nebraska reports, the Supreme Court of Nebraska says:

> "**The writ of error coram nobis,** to bring into the records facts which were unknown to the defendant at the time of trial, through no lack of reasonable diligence on his part which, if known at the time of the trial, would have resulted in a different judgment, **exists in this state under Section 49-101, Comp. St. 1929.**"

In the case of *Taylor, Admr.* v. *Koenigstein*, 128 Neb. 809, 260 N. W. 544, the adoption of the common law by Section 49-101 is recognized.

A number of cases are cited by respondent on page 25 of his brief which indirectly question whether the right of a sovereign to priority is based on the English common law or on an English statute. Any question on this point is fully answered by the opinion of Justice Brandeis in *Marshall* v. *New York*, 254 U. S. 380, where he says, referring to the right of a sovereign to priority, at page 386:

> "The fact that the right rests on the common law, independently of any statute, does not, of course, affect the right of enforcement in the federal courts."

## 2. Opinion of Supreme Court Commission Is Not Entitled to Any Consideration.

Respondent concedes that the Supreme Court of Nebraska has not passed upon the existence in Nebraska of the right of a sovereign to priority. However, on page 25 respondent refers to an unreported opinion of a previous Supreme Court Commission and the opinion is set out at length in the appendix. The opinion does not support respondent's contention that the right of a sovereign to priority is not recognized in Nebraska.

In the first place, a decision by the Supreme Court Commission **does not establish any precedent.** Section 27-224, C. S. of Neb. 1929, specifically provides with reference to such decisions:

> "Such proceedings shall not be published in the reports of the court or in any other reports, **and shall establish no precedent and be authority only in that particular case.**"

In the recent case of *McIntosh* v. *Standard Oil Co.*, 121 Neb. 92, 236 N. W. 152, the Supreme Court of Nebraska refused to consider a Commissioner's opinion which had been cited to it and said:

> "As to the case of *Lincoln Drug Co.* v. *Davidson*, No. 24836, on which the defendant relies, it may be said that **this court can give no consideration whatever to the latter** in the instant case. **It is a commission opinion.**"

The statement near the end of page 25 of respondent's brief that the commissioner's opinion is "considered the law of the state until overruled by an express opinion of the court itself", is unsupported by any authority and is directly contrary to the statutory provision and the holding in *McIntosh* v. *Standard Oil Co.*, *supra.*

Surely if the Supreme Court of Nebraska states that it "can give no consideration whatever" to a commissioner's opinion, it is entitled to no consideration by this court.

However, if consideration is given to the commissioner's opinion, we do not believe the construction placed upon it by the respondent is correct. As a matter of fact the opinion specifically says that the authorities cited to sustain the sovereign right of priority "are convincing". The commissioner then approves the finding of the trial court that because the Nebraska law provides a complete plan for winding up the affairs of a bank, the sovereign right of priority did not apply. The opinion therefore appears to recognize that the school district would have been entitled to the priority of a sovereign if the case had not been governed by a specific banking statute.

If the commissioner intended to hold the sovereign right did not exist in Nebraska in any case, why did he cite authorities to show such right could not be allowed where a specific statute covered the rights of creditors of an insolvent bank? The opinion says that no Nebraska decisions have been cited to sustain the contention that this right exists and refers to an old New Jersey case holding that because such a right has never been asserted, it would seem to negative its existence. The commissioner further says that he has no knowledge of the right having been asserted in Nebraska. This can hardly be construed as an assertion that the right does not exist in Nebraska in view of the previous statement that the authorities holding such right to exist were "convincing".

If Nebraska had never asserted this power, it would hardly negative its existence. Treason against the state of Nebraska is a crime but because the state has never had occasion to prosecute anyone for treason would not prove that the right to do so no longer exists.

The same argument that a right did not exist because it had not been asserted for many years, was made in the Supreme Court of Nebraska in the case of *Carlsen* v. *State*, 261 N. W. 339, not yet found in Nebraska reports. In that case the plaintiff sought to use the common law writ of error, coram nobis. It was insisted that the right had become obsolete because of disuse in Nebraska and no case appears to have been found where it had been resorted to in Nebraska. However, the Supreme Court held that the right existed at common law when the section now known as 49-101, C. S. Neb. 1929, was adopted in 1866, and therefore it became and remained a part of the laws of Nebraska notwithstanding the fact it had not been asserted during the seventy years existence of the state.

Furthermore, if the commissioner's opinion was construed to hold that the sovereign right to priority did not exist in Nebraska, it would be only dicta, inasmuch as the opinion had previously held such right would not be applied because of a specific statute fixing the rights of creditors of a failed bank. We therefore submit that this court is not justified in considering the commissioner's opinion when by express statute, as well as a recent decision of the Supreme Court of Nebraska, the opinion is not entitled to consideration. Even if the opinion were construed to hold the right in question did not exist in Nebraska it would be most unusual to consider it as in any way a precedent for this court when by statute and decision it cannot be considered by the Nebraska courts.

### 3. A Sovereign Cannot Be Deprived of Its Right to Priority By Mere Inference.

On page 26 respondent contends that because some Nebraska statutes relating to payment of creditors do not give the state a priority it must be inferred such right

does not exist in Nebraska. But this contention of respondent violates the principle that a sovereign can only be deprived of its right to priority by special constitutional or legislative action and not by mere inference. This rule is stated in the recent case of *Commonwealth of Pennsylvania* v. *Stocker*, 70 Fed. (2d) 453, 454 (C. C. A. 3), as follows:

> "* * * Against this proposition cases generally, and cases in Pennsylvania, itself, are strong to the effect that **a state cannot be deprived of its rights of a sovereign by inference, that it must be manifested 'by explicit terms' and 'by appropriate constitutional or legislative action.'** *Commonwealth* v. *Baldwin*, 1 Watts (Pa.) 54, 55, 26 Am. Dec. 33; *Booth & Flinn* v. *Miller*, 237 Pa. 297, 307, 85 Atl. 457, 460. See *In the Matter of Neiderstein*, 154 App. Div. 238, 138 N. Y. S. 952; *In re Alamac Operating Corporation*, (C. C. A.) 42 Fed. (2d) 120."

Furthermore, the cases cited by respondent do not support his argument on this point. On page 26 he quotes from the opinion in *In re P. J. Potter's Sons*, 143 Fed. 407 (D. C. Ky.), holding that the right to priority under Section 64b must be evidenced by statutory provision or judicial rule. Of course, in the present case a statutory rule is involved, namely the statute in Nebraska adopting the common law, and under the reasoning in *Denver* v. *Stenger*, 295 Fed. 809 (C. C. A. 8), cited in our original brief, the common law right of priority accorded a sovereign became a part of the Nebraska law. Respondent failed to call the court's attention to the fact that the foregoing case of *In re P. J. Potter's Sons* was reversed by the Circuit Court of Appeals and a priority allowed. See *Smith* v. *Mottley*, 150 Fed. 266 (C. C. A. 6).

A number of statutes are referred to by respondent on pages 26 and 27 as not containing any provision for

priority to debts due the state of Nebraska. The fact that such priority is not specifically given the state is an indication that the right of the state to a priority exists under the common law as adopted by the statute heretofore cited. In this connection the case of *Alabama* v. *Martin*, 256 Fed. 313 (C. C. A. 5), is cited by respondent on page 27 as holding that the absence of a statutory provision granting priority to a state indicated an intention that no such priority existed. In that case it was held that Alabama was not entitled to priority of a debt owing by bankrupt for hire of convicts. The court stated that while the common law of England had been adopted by statute in Alabama, yet other statutes seemed to be inconsistent with the priority claimed to exist in favor of the state. The other statutes mentioned were one giving priority in payment of taxes owing by an insolvent estate and another statute governing an assignment for the benefit of creditors which allowed the same priority. It was held that inasmuch as the statutes mentioned did not give the state priority except for taxes, "furnishes some basis for an inference that the lawmakers recognize that debts owed by the state are not entitled to priority except when expressly provided for".

The basis for this decision is not to be found in Nebraska. Section 6-124 of the C. S. Neb. 1929, cited by respondent and relating to assignments for creditors, provides first for payment of fees, second taxes, third preferred claims in full and fourth, other creditors. The third provision could very properly include preferred claims due the state, county or city for debts other than taxes which had already been mentioned. Section 30-615, C. S. Neb. 1929, cited by respondent, relates to estates of insolvent debtors and provides first for payment of funeral expenses, second for expenses of last illness, third for payment of debts having preference by laws of the

United States, and fourth for the payment of debts due other creditors. The fact that it does not mention taxes or other debts due the state indicates that it recognized the right of the state to such priority without including it in the statute. Consequently both grounds for the reasoning in the Alabama case are absent under the Nebraska statutes. We do not find that the Alabama case has ever been cited and even if it supported respondent's contention it would be contrary to the more logical rule announced by the Eighth Circuit in *Denver* v. *Stenger* and by the Third Circuit in *Commonwealth* v. *Stocker*, heretofore cited.

Cases are cited by respondent on page 28 relating to failed banks. We do not see the materiality of these cases to the questions presented by this appeal. The bankrupt was not a bank but was a trust company. The cases cited relating to banks involve express statutes relating to bank deposits.

We therefore assert that neither the Nebraska cases or statutes cited in any way show an intention to deny the right of the state or its agents to the priority accorded a sovereign. A sovereign will not be deprived of such right by mere inference but only by constitutional or legislative action.

## III.

### Surety Is Subrogated to Right of Sovereign Including Priority.

Respondent at the end of page 28 suggests that if the City was protected by a bond it should not be allowed the sovereign right of priority because the reason for allowing such priority, namely, protection of public funds, does not exist. We do not believe that under the limited scope of this appeal any question can be raised by respondent concerning the right of the surety to be subrogated

to the City's claim upon payment thereof. But even if the question is considered, it is without merit. The record shows that at the time of the hearing on the right of the City to priority it had not been paid one cent on its claim by the bankrupt or by any surety. The fact that subsequent to the hearing the City may have received a payment to apply on its claim from the surety should not destroy the right of priority in the payment of the claim. The District Court held that the surety became entitled to all of the rights of the City (R. 58). The rule appears to be definitely established that a surety having paid an obligation and taken an assignment thereof is entitled to be subrogated to the priority rights of a sovereign. See *U. S. F. & G. Co.* v. *Union Bank*, 228 Fed. 448, 453 (C. C. A. 6). *In Hunter* v. *U. S.*, 30 U. S. 173, 182, this court, in holding the right of a sovereign to priority passed to a surety who paid the government, says:

> "The same right of priority which belongs to the government attaches to the claim of an individual, who, as surety, has paid money to the government. Under this provision, Smith could claim a preference to other creditors for the money he paid as surety for the Crarys; and on his right the priority of the government is asserted."

To the same effect see *In re Baltimore Pearl Hominy Co.*, 5 Fed. (2d) 553 (C. C. A. 4); *American Bonding Co.* v. *Reynolds*, 203 Fed. 356 (D. C. Mont.).

In *Shropshire* v. *Bush*, 204 U. S. 186, it was held the priority allowed under the Bankruptcy Act to wage earners extended to assignee. The court emphasizes the fact that the Bankruptcy Act allows priority to the "debt", not to the person of the creditor.

The statement is made by respondent on page 29 of his brief that the allowance of priority to his claim would:

> "* * * certainly violate the spirit of the bankruptcy law, and under the rule of this court, as stated in *Local Loan Company* v. *Hunt*, 292 U. S. 234, 78 L. Ed. 1230, the court would be justified in denying the priority even though the state itself had by definite law given such priority."

The statement is not supported by the case mentioned in the foregoing quotation. That case held an assignment of wages did not create a lien as to wages earned after bankruptcy, even though the Illinois court had held to the contrary. Justice Sutherland stated that to hold the assignment valid as to wages earned after bankruptcy would violate the purpose of the Bankruptcy Law, namely, to relieve a debtor of his obligations and give him an opportunity to start over. Giving priority to the City's claim would not violate the purpose of the Bankruptcy Act as announced in the foregoing case. If the City was entitled to priority under the laws of Nebraska and Section 64b of the Bankruptcy Act applied to a municipal corporation, it would be a violation of the express provisions of that section to deny priority to the claim, rather than a violation of the purpose of the act by allowing it.

To summarize, we do not believe the respondent can now question the right of the surety to be subrogated to the City's priority because of the limitation contained in the order granting certiorari. But even if that question is considered the right to such priority attaches to the debt and if the surety paid the City, then the surety would acquire the same rights as the City had.

## CONCLUSION.

The language used in Section 64b shows an intention to give all debts the same priority which they would have received under the laws of a state or of the United

States and to construe this section to exclude a municipal corporation would be an unjust and unfair discrimination. If Section 64b is construed to apply to a municipal corporation then under the authorities cited in our original brief, the City's claim is entitled to the priority accorded a sovereign at common law. No sound reason has been given by respondent why such right of priority was not included in the common law as adopted by the statutes of Nebraska.

A reasonable construction of Section 64b and a logical application of that section entitles the claim of the City to the priority it would have received under the statutes of Nebraska.

Respectfully submitted,

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